Comparative Examples:

A. Bonus Option Comparisons

TABLE 1

Bonus Option Comparisons		
OPTION	**High-3 Retirement**	**CSB / REDUX**
Bonus	None	**$30,000 Lump Sum Payment at 15th Year of Service**
Service Obligation	**None, but... Member Must Serve 20 Years to Qualify for Retirement**	**Member Must Agree to Remain on Continuous Active Duty to 20 Years of Service**
Retired Pay Computation		
System	High-3	**REDUX 1986 Military Retirement Reform Act**
Base	**Average Monthly Basic Pay over Highest 36 Months**	**Average Monthly Basic Pay over Highest 36 Months**
Multiplier	**2.5% per Year of Service**	**2.5% per Year of Service Less 1 Percentage Point for Each Year Less Than 30 Restored to Same as High-3 System at Age 62**
COLAs*	**Full Inflation Adjustment Equal to the Annual Increase in CPI-W****	**Reduced Inflation Adjustment Equal to Annual Increase in CPI-W minus 1 Percentage Point With A One-Time Readjustment at Age 62**

* Cost-of-Living Adjustment
** Consumer Price Index for Urban Wage Earners and Clerical Workers

In Table 2 , 3 options are shown, the member elects the CSB/REDUX but allocates it in different ways: (1) A base case, (2) An option with a reduced UNISERV contribution, and (3) An option with a significant allocation of the CSB to a major expense (Vacation expense of $4,000). You can gain some insight by looking at the results, but don't base your decision on these cases. Instead, evaluate things using your personal circumstances.

In Option 1 the member deposits as much as possible in the UNISERV given a contribution from basic pay that will total $1,500 for the year. That leaves $9,000 to put in the UNISERV and $21,000 of taxable income from the CSB. In all cases we use a total annual tax rate of 30% (Federal, state, and local taxes) for current and future taxable earnings. This results in $6,300 of tax for Option 1 and the after-tax balance of $14,700 is invested. In each option, the UNISERV and other investments are evaluated at both 8% and 10% rates of return.

In Option 2, the member elects a reduced UNISERV contribution of $5,000 and even though the full after-tax balance is invested, there is less to invest.

In Option 3, the same $9,000 from Option 1 is invested in the UNISERV but the member spends $4,000 on a vacation.

TABLE 2
Bonus Allocation and Investment GrowthComparative Examples

Allocation Type	Amount of Bonus Allocated		
	Option 1	Option 2	Option 3
UNISERV	$9,000	$5,000	$9,000
Taxes	$6,300	$7,500	$6,300
Vacation	$0	$0	$4,000
After-Tax Investment	$14,700	$17,500	$10,700
Bonus Total	$30,000	$30,000	$30,000

	Potential After-Tax Accumulated Assets*					
	Option 1		Option 2		Option 3	
Years After Bonus Election	Rate of Return of Invested Funds					
	8.0%	10.0%	8.0%	10.0%	8.0%	10.0%
0	$21,000*	$21,000*	$21,000*	$21,000*	$21,000*	$21,000*
5	$28,560	$30,764	$28,123	$30,181	$24,618	$26,464
10	$38,950	$45,258	$37,733	$43,503	$32,482	$37,819
15	$53,272	$66,874	$50,730	$62,903	$44,355	$55,979
20	$73,076	$99,268	$68,351	$91,266	$61,227	$83,835
25	$100,546	$148,042	$92,304	$132,902	$84,927	$126,332
30	$138,771	$221,831	$124,953	$194,287	$118,260	$191,382
35	$192,129	$333,991	$169,584	$285,199	$165,196	$291,285
40	$266,844	$505,258	$230,773	$420,460	$231,475	$445,360
45	$371,783	$767,946	$314,917	$622,660	$325,338	$683,936

30% Tax Rate on All Taxable Money

*All cells show the accumulated after-tax value of the invested bonus money at the year indicated in the lefthand column. Money spent on a vacation is reflected in the year 0 but not in any other year. Notice that the year 0 values are all $21,000. This is due to the way we valued the funds. For example, look at option 3, year 0. $9,000 is deposited in UNISERV and is not included in taxable income for the year. Future UNISERV earnings will not be taxed until the money is withdrawn. The advantage of UNISERV is that earnings accrue on money that otherwise would have gone to pay taxes. This leaves $21,000 in taxable income, and at the 30% tax rate, $6,300 tax is due, leaving $14,700: $4,000 for the vacation and $10,700 to put in an after-tax investment. We now have $23,700 in funds or on hand for the vacation: $9,000 in UNISERV, $4,000 for the vaction, and $10,700 in after-tax investments. Of this $23,700, however, $2,700 in taxes will eventually be due on the $9,000 in the UNISERV account (30% tax rate). Thus, the value of after-tax assets shown is $21,000: which includes $6,300 of UNISERV funds ($9,000 - $2,700), $4,000 in vacation money and $10,700 in an after-tax investment.

Values shown for all subsequent years assume the UNISERV and after-tax investment remain in their respective accounts, but 30% of any UNISERV funds are excluded from the shown accumulated value of after-tax assets. This accounts for the fact that UNISERV funds must still be taxed when you withdraw them. Thus, we avoid the impression that all UNISERV money could be withdrawn and spent as desired. Earnings on the money in the after-tax investment are assumed to be taxed at 30% each year and are no longer in that account and all of that money may be withdrawn and spent whenever desired with no further taxes due.

To illustrate, look at Option 1 after 20 years under the 8% rate of return. The value shown is $73,076, which includes $29,364 of UNISERV funds, $43,712 in the after-tax investment. The UNISERV account is actually $41,949, but we have not included the $12,585 of taxes that must eventually be paid (if the 30% rate remains in effect). All of the $43,712 in the other investment account are included because it is all after-tax money.

Section 2 - REDUX RETIRED PAY VERSUS HIGH-3 RETIRED PAY

Differences in Retired Pay: If you elect the CSB, you must:

(1) Agree to remain on active duty until you have 20 years of active duty service, and

(2) Have your future retired pay computed under the provisions of the 1986 Military
Retirement Reform Act (1986 MRRA, also called **REDUX**). REDUX retired pay will be
less than retired pay under the High-3 system due to:

> **A reduced multiplier until age 62**; For each year short of 30, it is 1 percentage
> point less than the High-3 multiplier. The multiplier is restored at age 62 to the
> same multiplier as the High-3 system.

Retired Pay Multiplier for 20 to 30 Years of Service											
System	Years of Service										
	20	21	22	23	24	25	26	27	28	29	30
High-3	50.0%	52.5%	55.0%	57.5%	60.0%	62.5%	65.0%	67.5%	70.0%	72.5%	75.0%
REDUX	40.0%	43.5%	47.0%	50.5%	54.0%	57.5%	61.0%	64.5%	68.0%	71.5%	75.0%

Reduced annual Cost-of-Living Adjustments (COLAs) that are 1 percentage point less than
inflation as measured by the Consumer Price Index for Urban wage Earners and Clerical Workers
(CPI-W). The following chart compares the COLAs for selected rates of inflation. COLAs are set to
the nearest $1/10^{th}$ of 1 percent. At age 62, a COLA readjustment is made to bring REDUX retired
pay to the same amount as the High-3 retired pay when taken in conjunction with the multiplier
readjustment. After age 62, reduced COLAs will apply.

| Annual Retired Pay Cost-of-Living Adjustment										
System	Observed Increase in Consumer Price Index (CPI-W)									
	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%	4.5%	5.0%
High-3	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%	4.5%	5.0%
REDUX	0.0%	0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%

Projections and Comparisons Over Time:

We compare REDUX to the High-3 retirement by looking at an E-7 retired at age 40 with 20 years of
service. We assume inflation is 3% each year and the retiree lives to be 80 years old. Chart 1 shows
the actual gross retired pay each year. The pattern of retired pay is informative! First, there is the
initial difference due to the reduced multiplier. This is greatest if you retire with just 20 years of
service. The gap then increases each passing year due to the reduced REDUX COLAs before age 62.
At age 62, REDUX retired pay is increased to exactly equal the High-3 retired pay. After that, a gap
again develops as a result of the reduced REDUX COLAs.

With 30 years of service, the patterns would be similar with two main differences: First, the levels of
REDUX and High-3 retired pay start out equal because each is 75% of High-3 average basic pay --
there is no multiplier reduction with 30 years of service. Second, the gap won't grow as much before
age 62 because the member is 10 years older (closer to age 62) at the time of retirement. **This is an**
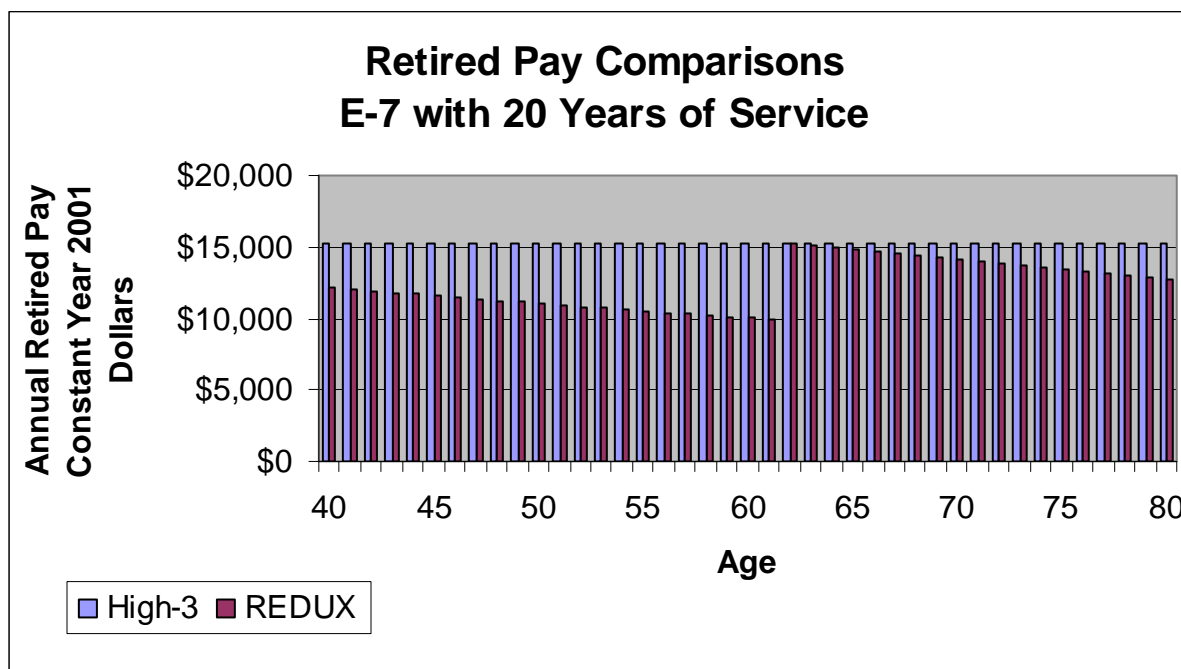
important consideration -- the longer you serve and the older you are at retirement, the less the percentage reduction of your future retired pay under REDUX.

CHART 1

Retired Pay Comparisons
E-7 With 20 Years of Service
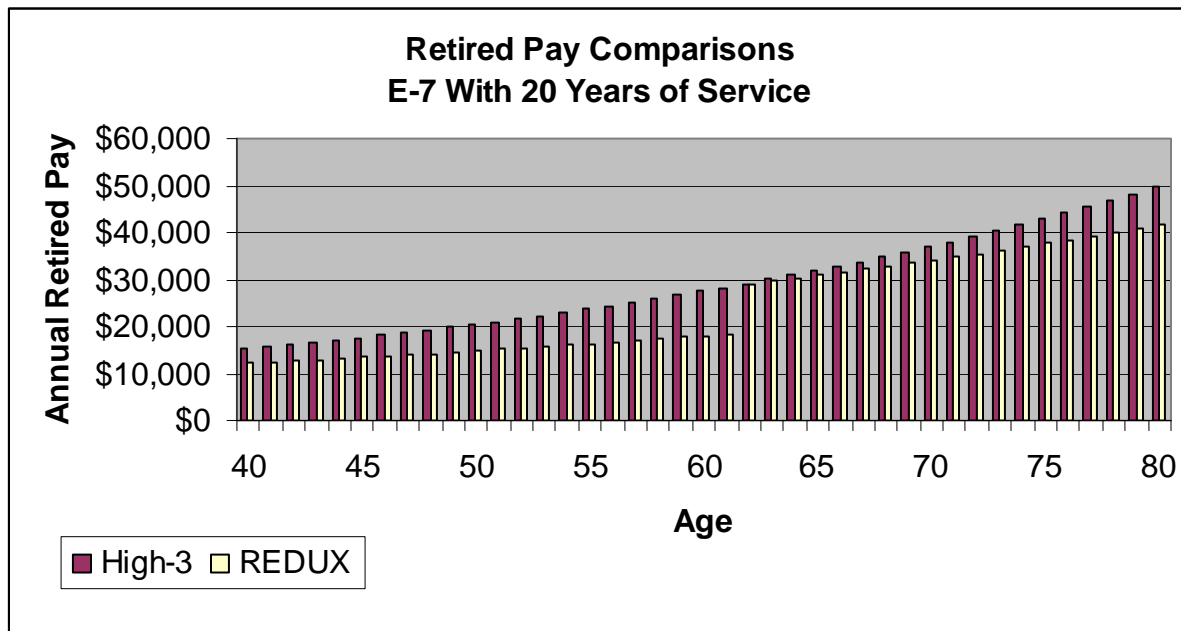
In this example, COLAs drive up the High-3 retired pay to be, at age 80, more than 3 times the initial value. Inflation does the same thing to the cost-of-living. While this member's retired paycheck at age 80 is 3 times what it was at age 40, it buys no more or less because of the increased cost-of-living. Instead of looking at the actual projected levels of retired pay in the future, we could look at the money in terms of how much it would buy today (in the year 2001). We call this constant Year 2001 dollars. These results are shown in Chart 2. Note the same relative pattern of retired pay, but in this case, the High-3 retired pay is constant over the years, having the same purchasing power in every future year as it did upon retirement. The reduced COLAs under REDUX cause those payments to gradually decrease in terms of constant dollar value except for the age 62 readjustment.

CHART 2

Retired Pay Comparisons
E-7 with 20 Years of Service

Annual Retired Pay Constant Year 2001 Dollars (y-axis)

Age (x-axis)

Legend: ■ High-3 ■ REDUX

An E-7 retired at age 40 with 20 years of service would receive High-3 retired pay through age 80 that totals over $600,000 constant Year 2001 dollars. REDUX retired pay would total about $115,000 less (19%). The big question is how this compares to the $30,000 bonus at the 15th year? Would anyone give up $115,000 in constant year 2001 dollars from future retired pay in exchange for $30,000 today? Given the right conditions, they probably would! It depends on what happens to the $30,000 over time compared to the extra retired pay of the High-3 system over CSB/REDUX.
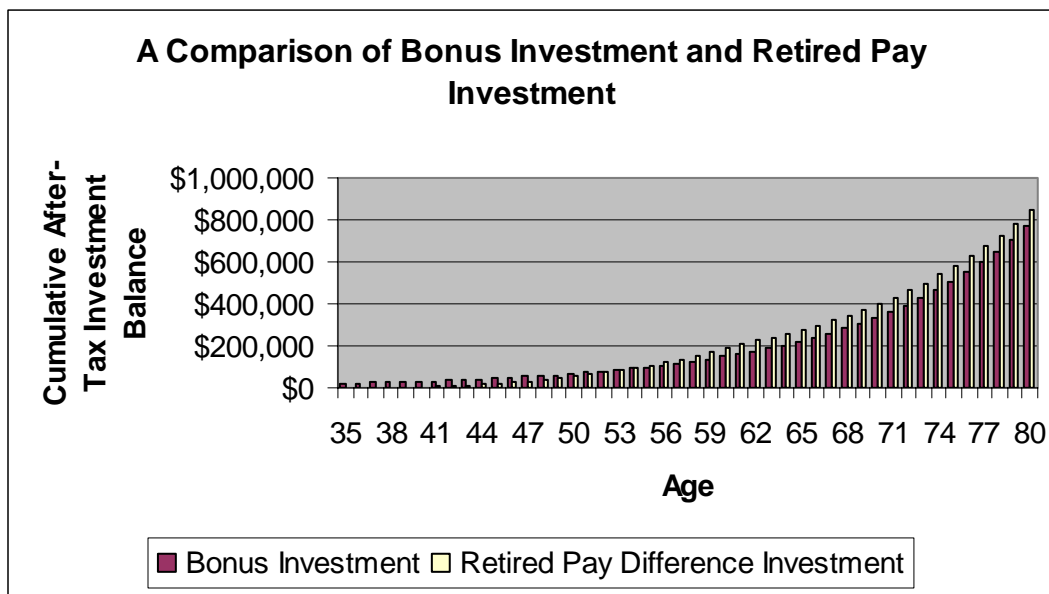
We must make assumptions about the following: (1) Grade at retirement, (2) Years of service at retirement, (3) Life expectancy (how long you'll live to collect retired pay), (4) Return on investments, (5) Tax rate, (6) Annual inflation (Consumer Price Index increase), and (7) Pay table increases before retirement.

Chart 3 shows the results under the following assumptions: (1) E-7, (2) 20 years of service, (3) Life expectancy of 80 years, (4) 10% annual rate of return on all investments, (5) 30% total tax rate, (6) 3.0% annual inflation, and (7) 3.5% annual pay increases. Under these conditions, the invested REDUX bonus is worth more than the invested extra retired pay until the retiree reaches age 54. After that, the investment of the extra-retired pay will be greater.

Caution! One set of numbers is not enough information to make this kind of decision. Consider whether you would really save the extra retired pay and the possibility that you might stay in service longer while your bonus investment grows and then retire with less reduction in retired pay.

CHART 3
Survivor Benefit Plan (SBP) Implications

A Comparison of Bonus Investment and Retired Pay Investment

Cumulative After-Tax Investment Balance

Age

◼ Bonus Investment ☐ Retired Pay Difference Investment

If you elect the CSB/REDUX option, you'll find that the SBP coverage available to you will work just a bit differently than it would under the High-3 retirement. The main difference is that under REDUX, the computation of your premiums and benefits will not reflect the multiplier reduction for retirement with less than 30 years of service. As a result, your premiums, while under age 62, will be a slightly higher percentage of retired pay than under the High-3 retirement. This will cause SBP to be a bit less attractive under the REDUX system -- about 5-10% more expensive for lifetime cost versus benefits. The exact impact would depend on when you retire and how you value money over time. We don't want to complicate your CSB/REDUX decision with an equally complex benefit, the SBP, but you should at least recognize that it could make the CSB slightly less attractive.